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STATE FOR NEA/I, S/I AND EEB
STATE PASS OPIC:DZAHNISER AND RMOSBACHER, JR.
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SUBJECT: OPIC PRESIDENT/CEO'S VISIT TO BAGHDAD -- FUTURE
MORTGAGE FACILITY FACES POLICY, REGULATORY, POLITICAL AND
PRACTICAL CHALLENGES

REF: BAGHDAD 1389

SUMMARY

1. (SBU) OPIC President and CEO Mosbacher's two-day visit to discuss a mortgage facility for low- and moderate-income workers was useful in allaying Post's concerns set out reftel regarding the risk of crowding out of a nascent private bank sector; the role of the Trade Bank of Iraq (TBI) in the facility; and OPIC's readiness to engage in an economy with important legal and regulatory ambiguities. The question remains of undermining the GOI's monetary policy by setting up a facility that lends in dollars. New issues came to light pertaining to the GOI ratification of the U.S.-Iraq Investment Incentive Agreement of 2005 as an essential legal framework for OPIC operations in Iraq; the extent to which a large number of Iraqi ministries and institutions will need to be brought into the approval process for the facility; and the conundrum of designing a mortgage product that is in fact affordable to the low- and moderate-income workers it targets. OPIC has committed to applying the information acquired on this visit to a formal proposal for the facility.
END SUMMARY.

INCLUDE, NOT CROWD OUT
PRIVATE BANKS

2. (SBU) OPIC President and CEO Robert Mosbacher, Jr., visited Baghdad May 8 and 9, accompanied by Robert Drumheller, Vice President for Structured Finance; Rodney Morris, Vice President for Insurance; and Dulce Zahnhiser, Chief of Staff. David Strine, Managing Director of the Iraq Middle Market Development Foundation, an OPIC-funded NGO, joined the team for selected meetings. Although the subjects of increasing OPIC exposure in its SME lending and classic insurance products were raised with all interlocutors, the primary objective of the trip was to explore the feasibility of a pilot program for a new housing mortgage facility for low- and moderate-income borrowers.

3. (SBU) Mr. Mosbacher directly addressed several of the concerns Post expressed reftel regarding the mortgage facility proposal in his call on Ambassador Crocker. He made clear that OPIC proposed to partner with the Trade Bank of Iraq (TBI) solely as an institution to share risk and provide additional resources to the pilot -- perhaps even shouldering the preponderance of risk. OPIC's intention was to push the administration of loans and the assessment of individual borrowers into appropriate private sector banks such as Credit Bank of Iraq or Baghdad Bank. OPIC training would build these lenders' back-office capacity and ability to

assess risk and administer loans, in keeping with OPIC's development mandate. The objective would be building rather than crowding out the private sector, and avoiding the creation of another state-owned lending institution. Opening participation to banks with Western partners could engage these well developed institutions in building Iraqi financial intermediation capacity, and perhaps engage the capital of those institutions.

14. (SBU) The OPIC team took on board the more complex question of making a lending facility denominated in dollars and lending at interest rates based on the U.S. Federal Funds rate compatible with Central Bank of Iraq (CBI) monetary policies aimed at de-dollarization of the economy and strengthening CBI control over monetary conditions. Post stressed that USG initiatives must accommodate the time needed for eventual reductions in the CBI's policy interest rate in line with the successful lowering of core inflation, which has remained stuck around 12 percent in recent months and may spike again on the back of expected GOI wage increases.

WANTED: A HOUSING
CONSTRUCTION INVESTOR

15. (SBU) Discussion of the need for builders to have the assurance of an immediate "take out" dominated the OPIC team's meeting with Ministry of Finance Senior Advisor Dr. Aziz Hassan Ja'far. Dr. Aziz stressed that Iraq does not have builders with deep enough pockets to enable them to construct "on speculation". The builder must be able to get

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the cost of the construction out of the project as soon as it is completed, he said. He noted that this requirement currently holds for all parties to significant construction projects in Iraq. Investors, designers, contractors, builders, suppliers -- none can wait the 20 years of a mortgage to recoup their outlays, and Iraqi banks are currently insufficiently capitalized to provide the "take out" up front, he said. The OPIC team stressed that it was precisely this lack in the financial intermediation system that the pilot mortgage facility sought to address. Dr. Aziz promised that if there are builders and financing able to do the projects, Iraq has the land, materials and labor to "build housing for 30 years -- we need 2.5 million units!"

16. (SBU) Dr. Aziz suggested that, on the specific question of land, the Ministries of Finance and of Municipalities could be counted upon to allocate appropriate parcels (as the majority holders of property rights in the country). He said it should be feasible to remove the cost of land from the price of the resulting housing, reducing the mortgage burden to the borrower.

TBI MUST GET ITS
BOOKS IN ORDER

17. (SBU) The OPIC Team continued in person their ongoing correspondence with the President and Chairman of the TBI, Hussein Al-Uzri, focusing on details of the proposal, and the Bank's uncertain bookkeeping. Mr. Mosbacher proposed that TBI take on more than half of the financing risk for the mortgage facility, stressing OPIC's limited Congressional appropriation for credit subsidies. He noted that along with asymmetrical risk sharing, OPIC was serious about building private sector banking capacity through limiting TBI's role to provision of capital. Given that the Iraqi housing market is characterized by nearly unlimited demand, the OPIC team asked how the mortgage facility pilot could be tested in a limited amount of time. They asked for Al-Uzri's opinion on whether it would be possible to set up a single entity financier/builder, and whether it was in fact feasible to expect the GOI to provide land free of charge.

18. (SBU) Al-Uzri told the team that he believed GOI provision of land could be expected. He noted that it would be a complex issue to obtain low-cost funds from GOI sources to support TBI's contribution to the facility, but that obtaining financing from commercial sources might be possible for the TBI. Bringing in another GOI entity to share risk might also be possible -- he suggested the Ministry of Construction and Housing's Iraq Housing Fund. Assuming three regional pilot projects, Al-Uzri opined that finding a capable builder in the northern region wouldn't be problematic, noting that reputable Turkish companies were operating there, in some cases with their own financing. He noted that security becomes an issue in the southern region requiring land parcels that are outside urban areas and fully securable, but that there are capable international companies operating in provinces such as Najaf and Karbala. Ensuring security and finding reputable builders were a problem in the central part of Iraq.

19. (SBU) Al-Uzri cautioned that the ownership structure of the implementing entity would be delicate, given the Iraqi prohibition against foreign ownership of land. The entity would have to be legally Iraqi in personality. Private bank participation in the financing would require incentives, perhaps including relaxation of the CBI's reserve requirements. The cost of the mortgages would be an issue -- Al-Uzri agreed with Embassy Senior Advisor for Private Sector Development June Reed when she noted that, with a median government employee salary of \$400/month, designing a mortgage of sufficient principal to build an acceptable home that can be repaid over 20 years with a monthly payment of one-third or less of salary (\$133/month) would be a real challenge. Al-Uzri said that many of these issues would have to be addressed as they arose in the implementation of the pilots -- "We will have to learn how to maneuver around the problems."

110. (SBU) The OPIC team said that their next step would be to customize several OPIC "templates" used for construction financing agreements, including designs for primary and secondary mortgage facilities. Key elements required in all such designs were specification of construction and labor

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standards, and protections for the borrowers and the lenders. They committed to providing customized templates in the near future. Last, the team made it very clear that OPIC would not be able to move forward with this partnership proposal if the TBI's financials were in any doubt, and urged Al-Uzri to issue the TBI's 2006 audit report immediately, and to finish the same for 2007 as soon as possible.

MANY MINISTRIES WILL NEED
TO BE INVOLVED

111. (SBU) The OPIC team met with the Deputy Minister of Construction and Housing (MoCH), Mr. Istabraq I. Alshouk, and the ministry's Senior Engineer, Mr. Majeed, to discuss MoCH experiences in the provision of subsidized housing. Alshouk expressed immediate readiness to agree in principal to the OPIC proposal, but noted that high-level concurrence and support from a number of other GOI authorities would be needed, including the Ministries of Finance and of Municipalities on questions of land; the CBI for questions related to the banking operations; the Ministry of Trade on the issue of company registration; the Ministry of Industry and Minerals on the provision of building materials; all other ministries whose employees might be the direct beneficiaries of the low-cost mortgages; and the Prime Minister himself. He said it seemed feasible for the MoCH's Iraq Housing Fund to co-partner in the proposal, bringing with it its experience in making some 8,000 mortgages to ministry employees, with a commitment of \$60 million in all provinces, with an average loan size of \$20,000.

JUST DO IT!

¶12. (SBU) Iraq's nominee for National Investment Commission (NIC) Chair, Ahmed Ridah, encouraged the OPIC team to move forward as quickly as possible with the mortgage facility proposal. He readily admitted that his own lack of full legal authority to take decisions as the head of the NIC had not stopped him making representations domestically and internationally about the investment regime he felt Iraq needed. He quickly listed a number of incentives he has declared the NIC would provide, including tax holidays, customs relief, one-stop shopping for business and investment registration -- none of which has any legal force. When the team brought up the need for the July 2005 U.S.-Iraq Investment Incentive Agreement to be ratified in the Council of Representatives in order to formalize OPIC's operations in Iraq, Ridah advised the team to press full steam ahead, regardless of legal standing. "Just do it -- that's what I'm doing!"

COMMENT:
THEY WILL COME --
BUT CAN IT BE BUILT?

¶13. (SBU) The OPIC team's meetings were useful in generating interest across several GOI ministries in a pilot program for a dollar-denominated mortgage facility benefiting low- and moderate-income borrowers, while at the same time revealing a number of challenges to be addressed in designing and implementing such a program. A first-order question has to be: Can an acceptable house be built at a price a moderate-income borrower can pay if the GOI assists with subsidies on both land and construction cost?

¶14. (SBU) As always in economics, with enough assumptions anything is possible. We start our back-of-the-envelope figures with the realistic parameters of free land from the GOI; a 20-year mortgage at 10% interest; and a moderate-income borrower with a monthly income of \$600. We ask that borrower to come up with a 20% down payment. We also ask that the borrower commit 50% of income to the mortgage payment (higher than OPIC's preferred optimum of 30%). That payment of \$300/month can service a mortgage of around \$31,000; adding the 20% down payment, the construction cost would be about \$39,000.

¶15. (SBU) This will not buy the kind of home that OPIC, the GOI, and the Iraqi people seek. A modest version of that house has a construction cost of at least \$50,000. Either the borrower must come up with a larger down payment, or the GOI must subsidize at a rate of some \$11,000 per unit. A

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more typical construction cost for a "New Home for the New Iraq" would be upwards of \$75,000 -- either the per-unit subsidy must climb, or the borrower's down payment goes up -- the second being the less realistic assumption of the two. The scenario based on a construction cost of \$39,000 was already weak, assuming as it did that the borrower has an income of \$600/month; can find \$8,000 for a down payment; and pay 50% of income for a mortgage. Make that income \$400, and the payment 30% of income, with no down payment, and the maximum mortgage amount looks like \$13,000. Would the GOI provide a \$27,000 - \$37,000 per unit subsidy? There is a clear consensus among not only analysts, but most GOI ministries, that a major effort is required -- but even with the subtraction of the cost of land, this is going to be very difficult.

¶16. (SBU) Then there will be the need to engage across a much wider range of ministries to generate specific support in terms of the provision of land, participation of employees, supply of materials, as well as agreement to OPIC-required

standards for construction, labor, materials, borrower and lender protection, etc. The CBI will need to be brought on board to ensure that the banking operations either fit within current prudential regulations or that these are modified -- all the while answering difficult questions about lending in dollars in contradiction to current monetary policy objectives. Issues of the TBI's still un-documented financial audits for 2006 and 2007 remain to be resolved; and, the NIC chairman-nominee's exhortation notwithstanding, OPIC's ability to maintain operations in Iraq in the absence of a ratified bilateral investment incentive agreement must be addressed. That said, the need for housing is critical and can only be addressed if the GOI participates in a variety of ways, including extensive financial support to ensure that low- and modest-income Iraqis can obtain adequate shelter sooner rather than later. OPIC's proposal may provide the impetus for the GOI and private sector to start down the long road toward a market-based housing sector. END COMMENT.
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